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88-409

No. 88-

Supreme Court, U.S.
FILED
SEP 7 1988
JOSEPH F. SPANIOL, JR.
CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1988

FIRST NATIONAL BANK, LEXINGTON, TENNESSEE,
Petitioner,

vs.

THE UNITED STATES,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

HANOVER, WALSH, JALENAK
& BLAIR
J. ALAN HANOVER 7906
(Counsel of Record)
STEPHEN R. LEFFLER 11038
219 Adams Avenue
Memphis, Tennessee 38103
(901) 526-0621
Counsel for Petitioner

E. L. MENDENHALL, INC., 926 Cherry Street, Kansas City, Mo. 64106, (816) 421-3030

QUESTIONS PRESENTED

I. Does 7 C.F.R. §1980.22(b) (1980), which excludes "late payment charges" from the scope of Farmers Home Administration loan guaranties, prohibit the agency from paying 25 percent interest to the holder of a defaulted loan calling for a fluctuating rate of interest which freezes at 25 percent on the date of default.

II. Do the words "See enclosed Loan Agreement," when used in a Farmers Home Administration form Lender's Agreement, incorporate the entire referenced document are only specific provisions of the referenced document.

LIST OF PARTIES

First National Bank of Lexington, Tennessee, a corporation organized under the laws of the state of Tennessee and a national banking institution, with its place of business being located in the city of Lexington, Henderson County, Tennessee, appeared as plaintiff in the United States Claims Court and as appellee in the United States Court of Appeals for the Federal Circuit. First National Bank of Lexington appears as appellant. The United States appeared as defendant in the United States Claims Court and as appellant in the Court of Appeals for the Federal Circuit. The United States appears as appellee.

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No. 88-

In the Supreme Court of the United States

OCTOBER TERM, 1988

FIRST NATIONAL BANK, LEXINGTON, TENNESSEE,
Petitioner,

vs.

THE UNITED STATES,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

First National Bank of Lexington, Tennessee, plaintiff in the United States Claims Court, prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Federal Circuit in *First National Bank of Lexington v. The United States* (Federal Circuit No. 88-1003, May 16, 1988), and the order of the United States Court of Appeals for the Federal Circuit entered June 13, 1988, denying First National Bank's petition for rehearing.

OPINIONS BELOW

The judgment and opinion of the Court of Appeals of which review is sought is reported officially at 846 F.2d 740. The opinion was issued by the Court as set forth in the appendix to this petition at App. 1. The order of the Court of Appeals denying the petitioner's request for rehearing is set forth in the appendix to this petition at App. 8. The judgment and opinion of the United States Claims Court from which the United States appealed to the Court of Appeals is officially reported at 12 Cl.Ct. 719, and is set forth in the appendix to this petition at App. 9.

JURISDICTION

The judgment and opinion of the Court of Appeals for the Federal Circuit was entered on May 16, 1988. The order of the Court of Appeals denying First National Bank's petition for rehearing was entered on June 13, 1988. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

REGULATION INVOLVED

The regulatory provision involved, 7 C.F.R. §1980.22, is set forth in the appendix to this petition at App. 23.

STATEMENT OF THE CASE

The case arose out of a Loan Note Guaranty issued by the Farmers Home Administration (FmHA). First National Bank purchased the guaranteed portion of a loan originally made by Houghton National Bank to Northern Industrial Sales & Service, Inc. The FmHA guaranteed the loan, thus making it attractive to purchasers on the secondary market. As part of its purchase, First National received as a package the standard loan documents, including the Promissory Note, Loan Note Guaranty, Lender's Agreement, Assignment Guaranty Agreement, and the Loan Agreement. All documents except the Promissory Note and the Loan Agreement were FmHA forms. Shortly thereafter, First National began receiving payments from the borrower.

First National failed to receive payments under the terms of the promissory note for the months of November 1981 through April 1982. First National agreed to a deferral of these payments with regular payments to resume in May of 1982. The last payment received by First National prior to repurchase by FmHA was in February 1982, which brought the loan current through October 26, 1981.

FmHA notified First National of FmHA's intent to repurchase First National's guaranteed interest. First National presented FmHA with a payoff request for $896,705.87 in principal and $189,896.51 in interest, which FmHA paid.

First National later discovered during a routine audit of books and records that it was entitled to additional interest based on a clause of the Loan Agreement that

provided that upon default the interest rate (which ordinarily would fluctuate based on the prime rate plus two percentage points) would freeze at twenty-five percent (25%) per annum.[1] First National made a demand for an additional $83,414.53 in accrued interest based on the twenty-five percent (25%) rate. That demand was refused by FmHA, thus setting the stage for this litigation.

First National filed a complaint in the United States Claims Court where jurisdiction was based on 28 U.S.C. §1491(a)(1). The complaint alleged that First National was entitled to the additional interest for the reasons set forth hereinabove. The United States replied that the FmHA guaranty did not extend to the payment of the 25 percent interest rate upon default because it constituted a "late payment charge" prohibited by 7 C.F.R.

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1. The applicable provision of the Loan Agreement is as follows:

> 11. *Default by borrower.* In the event of a default by the borrower in the performance of any of the terms, covenants, conditions or obligations contained in this agreement or in the attached exhibits, interest on the unpaid balance shall be at the rate of twenty-five percent (25%) per annum so long as the default occurs or exists, and lender may give the borrower written notice that the entire balance due is due and payable immediately. In addition to the foregoing rights, the lender shall have all the rights which arise upon the borrower's default, as are provided in the promissory note, real estate mortgage, security agreement, assignments and other documents in favor of the lender, together with the right to apply all monies on deposit with the lender to the payment of interest due, principal due and lender's costs, fees and expenses, including its attorneys' fees in reasonable amounts. If deposited funds are insufficient for the foregoing purposes, the lender shall have the right to charge all uncovered costs, expenses and attorneys' fees to the unpaid balance of principal and treat the same as principal subject to the aforesaid security document. The parties intend that the lender's rights will be cumulative and that those rights are freely assignable to, or for the benefit of, participating lenders and/or guarantors of the loan.

§1980.22 and because the Loan Agreement was not fully incorporated by reference in the Lender's Agreement. The parties filed cross-motions for summary judgment. The Claims Court held that there existed no genuine issue of material fact, and that First National was entitled to a judgment as a matter of law for the following reasons: (1) the additional payment sought by First National did not constitute a late payment charge as prohibited by 7 C.F.R. §1980.22; and (2) the FmHA's obligation to pay the additional interest pursuant to the Loan Agreement between the lender and the borrower was fully incorporated into the FmHA guaranty by reference.[2]

---

2. The incorporating language of the Lender's Agreement is as follows:

> 11. Obtaining from the borrower periodic financial statements under the following schedule:
>
> (see enclosed Loan Agreement)
>
> Lender is responsible for analyzing the financial statements, taking any servicing actions needed, and providing copies of statements and record of actions to the County Supervisor.

The isolated provision of the Loan Agreement that the Appeals Court found was incorporated by the above language is as follows:

> 9. *Borrower's covenants and restrictions.* Throughout the life of this loan, the borrower shall be subject to the following covenants and restrictions:
>
> A. Borrower will maintain books and records in accord with acceptable accounting standards and will furnish to the lender monthly financial statements of its financial condition and profits and losses, prepared from its books and records, within twenty (20) days after the end of the preceding calendar month.
>
> B. Borrower will furnish to the lender:
>
> 1. Monthly reports listing its accounts receivable and accounts payable with aging of the same.
>
> 2. Work and process reports.
>
> 3. Report of inventory of raw materials and parts.

(Continued on following page)

The United States perfected its appeal to the United States Court of Appeals for the Federal Circuit. That court reversed both findings of the Claims Court. The Appeals Court held that the additional interest sought by First National was outside the FmHA guaranty on the basis that *any* payment required after default or tied to a late payment of principal or interest constituted a "late payment charge." The Appeals Court further held that the entire Loan Agreement was not incorporated into the Lender's Agreement. Instead, the court held that only so much of the Loan Agreement was incorporated into the guaranty to allow the parties to determine the schedule for periodic financial statements to be supplied by the borrower.

REASONS FOR GRANTING THE WRIT

An Important Federal Question Is Presented Concerning the Effect of the Appeals Court Decision on the Farmers Home Administration and Its Numerous Other Holders of Similar Guaranteed Loans

The purchase and sale of government guaranteed loans on a secondary market is a widespread commercial

---

Footnote continued—

C. Borrower will furnish to the lender semi-annual financial statements prepared by certified public accountants; said statements may be prepared without audit.

D. Borrower will furnish as of December 31 of each year audited financial statements prepared by independent certified public accountants or by an independent public accountant licensed and certified on or before December 31, 1970, by a regulatory authority of the state or other political subdivision of the United States; said statement shall include the auditor's review in compliance with this agreement.

practice. Typically, a borrower will negotiate a loan from a private lender offering as collateral the guarantee of a governmental agency such as the Farmers Home Administration. The lender collects payments and services the loan. Most lenders, however, sell the loan at a discount to a holder in the secondary market. The holder pays the discount with the expectation of receiving full principal and interest payments during the life of the loan. The guarantee follows the loan into the hands of the holder, thus greatly enhancing its marketability with secondary purchasers.

The terms of the initial transaction are negotiable between the borrower and the lender, subject only to certain regulations set forth by the agency guaranteeing the loan. FmHA regulations specifically allow the parties to negotiate a loan based on a variable interest rate tied to a base rate, adjusted quarterly, with no ceiling or floor to restrict the fluctuations. 7 C.F.R. §1980.423 (1980). This arrangement is especially attractive for lenders and borrowers in commercial settings, since it allows the lender to take advantage of higher rates and allows the borrower relief during periods of lower rates.

As a testament to the attractiveness of such an agreement, literally thousands of such loans are negotiated and guaranteed by FmHA. The loan in the instant case is one such transaction.

This is a case of first impression and presents an important question of federal law which has not been, but should be, settled by this Honorable Court. During the long course of litigating this matter, neither party has been able to find an agency interpretation of the

term "late payment charge" that fits the facts of this case.[3] Nor has either party found any case law on point.

If the Appeals Court decision is allowed to stand, similar provisions of other FmHA loans will be instantly nullified. Similarly, other loans involving collateral agreements between borrowers and lenders that become part of the loan "package" (such as the Loan Agreement in this case) will be destabilized due to the uncertainty as to which specific provisions are incorporated and which provisions are excluded. An interpretation by this Honorable Court is necessary to stabilize the respective rights of secondary market holders and the FmHA in existing guaranty agreements and to establish an appropriate course of conduct for parties to future government guaranteed loans.

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3. The United States submitted one agency interpretation that, it was argued, was dispositive of the issue of whether an increase in the interest rate upon default constituted a late payment charge. That interpretation, dated November 9, 1982, opined that an additional two percent per annum interest charge on any payment arrearages under a note constituted a late payment charge. That case is easily distinguishable from the instant case. In that case, the two percent interest rate was to be an *additional* amount due under any circumstance. In the instant case, the Loan Agreement calls for a 25 percent interest rate upon default. If a fluctuating note rate of interest exceeds 25 percent on the date of default, the default rate would actually be *less* than the predefault rate, and thus would constitute a discount to the borrower rather than an additional charge. First National has consistently argued that the loan documentation should be interpreted from the date of execution and not from the date of repurchase when both parties have the advantage of 20/20 hindsight with respect to what interest rates would do.

CONCLUSION

Given the widespread use of fluctuating interest rates in government guaranteed commercial loans, the issue presented by this petition is certain to recur. The Court should grant a writ of certiorari to insure consistency of regulatory interpretation, to clarify the rights of existing holders in the secondary market, and to establish a consistent and clear means for future purchasers to assure themselves of receiving the benefit of their bargain.

Respectfully submitted,

HANOVER, WALSH, JALENAK
& BLAIR
J. ALAN HANOVER 7906
(Counsel of Record)
STEPHEN R. LEFFLER 11038
219 Adams Avenue
Memphis, Tennessee 38103
(901) 526-0621
Counsel for Petitioner

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

88-1003

FIRST NATIONAL BANK, LEXINGTON, TENNESSEE,
Plaintiff-Appellee,

v.

THE UNITED STATES,
Defendant-Appellant.

DECIDED: May 16, 1988

Before MARKEY, *Chief Judge,* DAVIS and SMITH, *Circuit Judges.*

DAVIS, *Circuit Judge*

The question is whether the Farmers Home Administration (FmHA), which guaranteed 90% of a loan made by a Michigan bank (the lender) to a private borrower, is liable to appellee First National Bank (FNB), the subsequent purchaser of the guaranteed part of the loan, for extra payments due after the borrower's default. The United States Claims Court held that the United States (on behalf of its agency, FmHA) was so liable (*First Nat'l Bank, Lexington, Tennessee v. United States,* 12 Cl. Ct. 719 (1987)) and the Government appeals. We reverse.

I.

The loan of $1,000,000 was made in July 1980 by the Houghton National Bank (lender) to Northern Industrial Sales and Service, Inc. (borrower). FmHA guaranteed 90% of that loan. FNB shortly purchased the guaranteed portion of the loan. The underlying promissory note provided that interest on the principal amount of the loan would accrue according to a variable interest rate initially established at 13% and adjusted quarterly to the New York prime rate plus 2% points. In addition to the promissory note, the loan package included a FmHA Loan Note Guarantee, a FmHA Lender's Agreement, an Assignment Guarantee Agreement, and a loan agreement between the borrower and the lender.

In November 1981 the borrower requested a temporary payment moratorium on the loan through April 1982, to which FNB, the lender and FmHA agreed. The borrower was, however, unable to resume payments on the loan and in November 1982 FNB made demand upon FmHA for the unpaid principal and accrued interest calculated at the applicable promissory note interest rates. In January 1983, FNB received a check from the FmHA (in the amount of $1,086,602.38) in satisfaction of FNB's demand.

In September 1984, FNB made a second demand on FmHA for an additional $83,414.53 in accrued interest; this demand was based on a clause in the loan agreement between the lender and the borrower, stating: "*Default by Borrower.* In the event of a default by the Borrower . . . interest on the unpaid balance shall be at the rate of twenty-five percent (25%) per annum so long as a default occurs or exists . . . ." FNB claimed that its first

demand on FmHA had inadvertently failed to take account of this 25% provision,[1] and the loan had been in default from October 26, 1981 through January 19, 1983 (when FNB received FmHA's payoff check).

FmHA refused payment of the additional sum, and FNB brought this suit in the Claims Court. The parties filed cross-motions for summary judgment, and that court, finding no genuine issue of material fact, held for FNB on the ground that (a) the additional payment sought was not a "late payment" prohibited by an FmHA regulation, and (b) FmHA's obligation for the additional interest was based on the loan agreement between lender and borrower, which (the court held) was fully incorporated into FmHA's guarantee.[2]

II.

In our view, the critical FmHA regulation (7 C.F.R. § 1980.22(b) (1980)) specifically provides that the additional payment demanded by FNB is outside the Government's guarantee.[3] The first two sentences of the regu-

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1. Under the formula set forth in the promissory note, the interest during the pre-default period was between 13% and 21.5%—and those were the percentages used in FNB's first demand on FmHA.

2. The Claims Court also awarded FNB pre-judgment interest on the $83,414.53 additional payment.

3. The regulation states in relevant part:

> (b) Late payment charges. *Late payment charges will not be covered by the Loan Note Guarantee.* Such charges may not be added to the principal and interest due under any guaranteed note. Late payment charges may be made only if:
>
> (1) Routine. They are routinely made by the lender in all types of loan transactions.

(Continued on following page)

lation deal with FmHA's guarantee, forbidding recovery of "late payment charges." The rest of the regulation, quoted in our footnote 3, provides for the conditions in which the lender (or subsequent holder) can assess "late payment charges" on the borrower. The Claims Court ruled that the term "late payment charges" referred only to flat charges, unrelated to principal and interest amounts, on any monthly payments made beyond a certain date—not to additional interest after default. However, the ordinary meaning in the English language of "late payment charges" is not so limited, and there is nothing in the record supporting the Claims Court's restrictive reading of the regulation. On the contrary, the term facially covers *any* payment required after default or tied to a late (and unexcused) payment. This is, for instance, its meaning under the comparable provision of the Truth in Lending Act (TILA), 15 U.S.C. § 1601, *et seq.*, 1638(a)(9), 1638(a)(8). *Johnson v. McCrackin-Sturman Ford, Inc.*, 527 F.2d 257, 266 (3d Cir. 1975) (late payment charges "generally refer to specific pecuniary sums that are assessed against the borrow solely because of his failure to make his payments in a timely manner"—giving as an example an increase in the interest rate); *Franklin v. Community Fed. Sav. & Loan Ass'n*, 629 F.2d 514, 517 (8th Cir. 1980) ("[E]ach increase [in the rate of interest as a "default,

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Footnote continued—

> (2) Payments received. Payment has not been received within the customary time frame allowed by the lender . . .
>
> (3) Calculating charges. The lender agrees with the applicant in writing that the rate or method of calculating the late payment charges will not be changed to increased charges while the Loan Note Guarantee is in effect.

7 C.F.R. § 1980.22(b) (1980) (emphasis added).

delinquency or similar charge"] can fairly be described as a charge levied by the creditor because of the debtor's late payment."). Similarly, Regulation Z under TILA (12 C.F.R. § 226.18(1)) has been officially interpreted by the staff of the Federal Reserve Board as including under "a late payment charge" an increase in the interest rate to the extent of the increase.

The Government relies heavily on two recent parallel interpretations of FmHA practice by FmHA officials, statements which the Claims Court discredited because they were not longstanding but contemporaneous, and were both made in connection with the current controversy. We do not put as much weight on these *ad hoc* statements as does the Government, but we are impressed by the categorical statement under oath of John Bowles, a high FmHA official, that FmHA's current interpretation—"including additional accrued interest attributable to the application of a higher rate of interest upon the indebtedness after default"—is "consistent with past policy and practice" of the agency (FmHA). That reasonable and uncontroverted administrative construction of the regulation (as employed by the FmHA in the past as well as the present) is entitled to respect by the court. *Udall v. Tallman,* 380 U.S. 1, 4, 16-17 (1965).

Nor does the Government's application of the regulatory term "late payment" to the current case conflict with the policies beneath the regulation. The purpose was apparently to bar a lender or holder from both accruing late payment charges against the borrower and also making demand upon FmHA for payment in full (including the accrued late payment charges) pursuant to its guarantee. Conversely, the lender or holder can always, after default,

protect itself by demanding and enforcing the Government's guarantee.[4]

For these reasons, we hold that the FmHA regulation 7 C.F.R. § 1980.22(b)) precludes the 25% post-default interest rate from being covered by the Government's guarantee.

III.

We also disagree with the Claims Court's ruling that the entire loan agreement (with its reference to 25% post-default interest) was incorporated into the Lender's Agreement. That holding is based on the provision in the Lender's Agreement (under the general heading "Servicing") that the lender's servicing responsibilities include:

> 11. Obtaining from the borrower periodic financial statements under the following schedule: — See enclosed Loan Agreement [this reference to the 'enclosed Loan Agreement' is typed in]—. Lender is responsible for analyzing the financial statements, taking any servicing actions needed, and providing copies of statements and record of actions to the County Supervisor.

This reference to the Loan Agreement is solely in connection with determining the schedule for the periodic financial statements borrower is to furnish and lender is

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4. FNB also argues that the 25% interest-after-default might well be lower than the variable interest normally chargeable under the note—and it would be bizarre if the "late payment" interest were less than that ordinarily provided. The short answers are that (a) in this case the variable interest never reached 23% and (b) at least during the past half-century the prime interest rate has never reached 23%. It is plain that the parties believed that the 25% post-default interest charges would be higher than the variable rates provided in the note.

to monitor. That specific purpose, totally unrelated to the current problem, was the only purpose for mentioning the Loan Agreement. As the Supreme Court said in *Guerini Stone Co. v. P.J. Carlin Constr. Co.*, 240 U.S. 264, 277 (1916):

> [I]n our opinion the true rule, based upon sound reason and supported by the greater weight of authority is that . . . [in] cases of express agreements in writing, a reference by the contracting parties to an extraneous writing for a particular purpose makes it a part of their agreement only for the purpose specified.

Moreover, the Lender's Agreement also provided that "This agreement is subject to all the requirements of the applicable Subpart of Title 7 CFR Part 1980," which include the regulation (7 C.F.R. § 1980.22(b)) we have held (in Part II, *supra*) to preclude the 25% interest "late payment" from being embodied in the guarantee. Making the Lender's Agreement "subject" to that regulation would invalidate the applicability, for the guarantee, of the late payment provision in the Loan Guarantee.[5]

IV.

Accordingly, we reverse the decision of the Claims Court and direct that FNB's complaint be dismissed.[6]

REVERSED.

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5. FNB likewise argues that the promissory note itself made the loan agreement and its default interest clause part of the guaranteed transaction, but the provision on which appellee relies does not have that effect.

6. Because of our disposition it is unnecessary to decide whether the Claims Court erred in awarding pre-judgment interest to FNB.

(Filed June 13, 1988)

Note: This Order has not been prepared for publication in a printed volume because it does not add significantly to the body of law and is not of widespread legal interest. It is a public record. It is not citable as precedent.

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

88-1003

FIRST NATIONAL BANK, LEXINGTON, TENNESSEE,
Plaintiff-Appellee,

v.

THE UNITED STATES,
Defendant-Appellant.

Before MARKEY, *Chief Judge*, DAVIS and SMITH, *Circuit Judges*.

ORDER

A petition for rehearing having been filed in this case,

UPON CONSIDERATION THEREOF, it is

ORDERED that the petition for rehearing be, and the same hereby is, denied.

FOR THE COURT:

/s/ Francis X. Gindhart
Francis X. Gindhart, Clerk

6/13/88
Date

cc: Mr. J. Alan Hanover
Mr. Paul J. Ehlenbach, DOJ

IN THE UNITED STATES CLAIMS COURT

No. 133-85C
Filed: August 5, 1987

FIRST NATIONAL BANK, LEXINGTON, TENNESSEE,
Plaintiff,

v.

THE UNITED STATES,
Defendant.

Accord & satisfaction; loan default; incorporation by reference; interpretation of 7 C.F.R. § 1980.22 (1980); regulatory construction; motion for summary judgment

J. Alan Hanover and *Stephen R. Leffler,* Memphis, Tennessee, for plaintiff.

Paul J. Ehlenbach, with whom were *Assistant Attorney General Richard K. Willard, David M. Cohen, Director,* and *Thomas W. Peterson, Assistant Director,* Washington, D.C., for defendant. *Ronald E. Gottschalk,* Department of Agriculture, of counsel.

OPINION

SMITH, Chief Judge.

This case is before the court on cross-motions for summary judgment. The dispute centers upon defendant's refusal to pay additional interest to plaintiff under the terms of a Farmers Home Administration Loan Note Guarantee. Plaintiff claims it miscalculated the amount owed and that defendant is therefore obligated to pay an

additional sum. Defendant asserts that the amount sought is not recoverable for several reasons: (1) the pertinent regulation prohibits such recovery, (2) the Loan Agreement was not incorporated by reference into the Lender's Agreement, (3) the parties entered into an accord and satisfaction which bars plaintiff's recovery, and (4) assuming plaintiff can prove mutual mistake and that the regulation does not prohibit such a payment, plaintiff is only entitled to $42,719.37, not the $83,414.53 which it claims. For the reasons set forth below, the court grants Plaintiff's Motion for Summary Judgment and, accordingly, Defendant's Cross-Motion for Summary Judgment is denied.

Facts

On July 31, 1980, plaintiff, First National Bank of Lexington, Tennessee ("plaintiff" or "FNB") a Tennessee corporation with its place of business in Lexington, Tennessee, purchased the guaranteed portion (ninety percent) of a loan in the amount of $1,000,000 made by Houghton National Bank ("Lender") to Northern Industrial Sales & Services, Inc. ("Borrower"). The loan purchase portion was fully guaranteed by the Farmers Home Administration ("FmHA"). Subsequently, plaintiff received the standard loan documents including: a copy of the Loan Note Guarantee, the Note evidencing the loan from Lender to Borrower, a copy of the Lender's Agreement, a copy of the Assignment Guarantee Agreement, and a copy of the Loan Agreement between Lender and Borrower. Plaintiff examined the aforesaid documents and determined that those documents conformed with plaintiff's understanding of the agreement and accepted the assignment of the loan.

Thereafter, plaintiff, Lender, and, the FmHA, agreed to Borrower's deferral of certain payments of principal and interest on the note from November, 1981, through April, 1982. However, it was also agreed that payments would resume in May, 1982. The last payment was received by plaintiff in February, 1982, which brought the loan current through October 26, 1981.

As a result of Borrower's default, plaintiff, on July 28, 1982, made demand upon Lender pursuant to the terms of the Assignment Guaranty Agreement to repurchase the guaranteed portion of the loan with interest. Upon declining to repurchase the guaranteed portion of the loan, Lender forwarded the matter to the FmHA for processing. Plaintiff made demand upon the FmHA on November 16, 1982, for payment in the amount of $1,064,045.90 with additional interest of $362.37 per day pending payoff.

The FmHA paid $896,705.87 for the outstanding principal and $189,896.51 for interest charges on or about January 19, 1983. This sum would appear to represent the exact amount of plaintiff's demand. Subsequently, a routine audit of plaintiff's books and records revealed that plaintiff had inadvertently used the wrong interest rate in its calculation of the guaranteed accrued interest in its original repurchase demand. During its original calculations, plaintiff failed to use the default provision of the Loan Agreement which provides in the event of a default for interest on the unpaid balance to accrue at the rate of twenty-five percent per annum. By letter dated September 20, 1984, FNB made a demand on the FmHA for an additional $83,414.53. The FmHA refused to pay the additional interest demanded and plaintiff

filed its complaint on March 7, 1985. Defendant argues that (1) plaintiff cannot recover penalty interest under the terms of the applicable regulation; (2) the twenty-five percent default provision of the Loan Agreement was not incorporated by reference into the Lender's Agreement; (3) plaintiff surrendered the right to collect additional interest when it entered into an accord and satisfaction with FmHA; or, in the alternative, (4) even if the regulations and loan documents allow plaintiff to recover interest and plaintiff is able to show a mutual mistake of fact, plaintiff miscalculated the amount owed by using the wrong date of default and is only entitled to judgment in the amount of $42,719.37, not the amount claimed ($83,414.53). The Claims Court has jurisdiction over the subject matter of this action pursuant to 28 U.S.C. § 1491 (1982).

Discussion

Summary judgment is appropriate only when there are no issues of material fact in dispute and judgment is appropriate as a matter of law. *Weide v. United States*, 4 Cl. Ct. 432, 435 (1984), *aff'd*, 765 F.2d 157 (Fed. Cir. 1985), *cert. denied*, 474 U.S. 822 (1985). Further, all doubts relative to material facts in issue for the purposes of ruling on a party's summary judgment motion must be resolved against the moving party. *South Louisiana Grain Services, Inc. v. United States*, 1 Cl. Ct. 281, 289 (1982).

Plaintiff's Motion for Summary Judgment and Defendant's Response and Cross-Motion for Summary Judgment raise four primary issues; they will be dealt with seriatim.

I. Whether the rate of interest applicable in the event of default is recoverable as liquidated damages or should be construed as a late payment charge and, therefore, not enforceable?

In determining whether this regulation bars plaintiff's recovery the court must determine what the regulation means by the term "late payment charges."

Title 7, Section 1980.22 of the Code of Federal Regulations ("Charges and fees by lender"), provides:

> (a) Routine charges and fees. The lender may establish the charges and fees for the loan, provided they are the same as those charged other applicants for similar types of transactions.
>
> (b) Late payment charges. Late payment charges will not be covered by the Loan Note Guarantee. Such charges may not be added to the principal and interest due under any guaranteed note. Late payment charges may be made only if:
>
> > (1) Routine. They are routinely made by the lender in all types of loan transactions.
> >
> > (2) Payments received. Payment has been received within the customary time frame allowed by the lender. The term "payment received" means that the payment in cash or by check, money order, or similar medium, has been received by the lender at its main office, branch office, or other designated place of payment.
> >
> > (3) Calculating charges. The lender agrees with the applicant in writing that the rate or method of calculating the late payment charges will not be changed to increased charges while the Loan Note Guarantee is in effect.

If the term "late payment charges" is equivalent to an additional interest charge in the event of default, then plaintiff is barred from recovery. If, on the other hand "late payment charges" refers to the type of charges often imposed by consumer lenders on individual late payments (flat charges unrelated to principle and interest amounts on any monthly payment made beyond a certain date), then it is apparent to this court that plaintiff's interest provision, as contained in the Loan Agreement, is not barred by the regulation.

There are three reasons for finding that the regulation does not bar plaintiff's interest provision. They relate to the regulatory history of the provision, to the plain language of the regulation and to the policy apparent on the face of the provision. These points will be dealt with individually.

Both parties to this case have specially researched the regulatory history of the provision involved in this matter.* Plaintiff has found nothing. Defendant asserts that Mr. James E. Trumbell's September 27, 1984 letter to Ms. Cindy M. Gore of plaintiff bank is "a practical construction and application of § 1980.22 by a government official in the field, [and] deserves a considerable degree of deference." However, in this matter there are two reasons that argue against any such deference. First, upon a review of Mr. Trumbell's letter, it would appear that he does not support defendant's contention. The letter notes not that this twenty-five percent interest provision is contrary to a clear regulation, but rather, "The primary

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*Argument on the Motions for Summary Judgment was held on March 13, 1986. At that time the court requested both parties to submit Post Argument Memoranda concerning the interpretation of § 1980.22.

reason for this [nonentitlement to the interest claimed] is that the account was never in a default status . . . ." The letter then later notes "*penalty language is acceptable,* but a note rate change requires proper language in the note and it does not exist." (emphasis added). And finally perhaps the "real" views of the agency are expressed when Mr. Trumbell notes, "We consider it greedy and involving questionable ethics." The letter also states "Also, in no way do we feel that our guarantee extends to any loan penalties, so we would also refuse payment on that basis."

It is quite clear that this letter does not help the defendant's proffered interpretation, and its logical inferences may even support plaintiff's interpretation. The second reason for not deferring to Mr. Trumbell's latter declaration supporting defendant's "interpretation", dated November 12, 1985, is that it was made for purposes of this litigation, in addition to its emphasis being different than the contemporaneous earlier letter. Mr. John Bowles' declaration of March 28, 1986, also is made in the context of this litigation, and amounts to no more than the statement that 'our attorneys position is right.'

Defendant also argues that Regulation Z at 12 C.F.R. § 226.18(l) (1986) interprets the type of interest "sought here as a late payment charge." This regulation is a disclosure regulation serving an entirely different function than the regulation at issue in the instant case. However, assuming that difficulty aside, the cited regulation seems to identify "late payment" with; "charges . . . added to individual delinquent installments by a creditor who otherwise considers the transaction ongoing on its original terms." 12 C.F.R. Part 226, Supp. I, § 226.18(l) (1986). Thus, even this analogy seems to support plaintiff's position. Finally, defendant's conduct prior to de-

fault, the signing of the Lender's Agreement and the Loan Note Guarantee, is evidence at a minimum that defendant's interpretation of this regulation, prior to this litigation did not appear to bar plaintiff's recovery. It must be presumed that defendant knew and understood what it was signing and would not have signed an agreement requiring the violation of a regulation when some of the agreement's provisions became operational. *Carpenter v. United States*, 4 Cl. Ct. 705 (1984), *aff'd without opinion*, 790 F.2d 91 (Fed. Cir. 1986).

Turning from the regulatory history to the regulation's plain language, that language seems to support the position that late payments are something other than additional interest in the event of default. The regulation notes that "Such charges may not be added to the principal *and interest due* under any guaranteed note." (emphasis added) 7 C.F.R. § 1980.22(b). This indicates that such charges are other than principal or interest due, like the flat fees commonly added to consumer monthly payments that are paid late. Also, the plain language states that late payment charges will be covered under certain conditions. This shows that the regulation is certainly not to be broadly construed as a flat prohibition of all "penalty type" provisions. Rather it indicates precise targeting at a certain type of late payment charge. The agency could have drafted it as a broad prohibition, but it did not. By analogy to contra proferentem principles in contract law this supports the logic of not stretching a regulatory provision to do a job that it was not designed to do.

The policy reason which apparently underlies the regulation is to prevent the government from being treated

differently than a regular borrower, i.e., by imposing an additional burden upon the government. *See* 7 C.F.R. § 1980.22(a). However, this was not the case here. The twenty-five percent interest rate applicable in the event of default, does not place a greater burden upon the government than upon any other borrower or guarantor. It is not a special repetitive surcharge, as a flat standard late payment charge would be, that might place a particular burden upon guarantors of a great many loans. Further, the policy of trying to make the loan guarantee process a competitive one, at arms length in an era of wildly fluctuating interest rates, is more consistent with plaintiff's reading of the regulation than defendant's.

II. Whether plaintiff's demand of a sum certain and defendant's tender of same constitutes an accord and satisfaction extinguishing defendant's alleged obligation.

If plaintiff entered into an accord and saitsfaction with the FmHA, it surrendered its right to the interest applicable in the event of default. However, if there is a mutual mistake, it would obviate the precondition for accord and satisfaction just as it obviates contractual intent in the ordinary contractual framework. 6A Corbin, Corbin on Contracts §1277 (1962).

> There is no doubt that if no part of the claim is in dispute and the creditor sends by mistake a bill showing less than the amount actually due the payment of that amount does not operate as a full satisfaction. . . . Under such circumstances, a promise by the creditor to accept the check as full satisfaction would be without any sufficient consideration.

> Just as in the case of other contracts, an accord can be set aside, or reformed and enforced, on the ground of fraud, accident, or mistake.

Id. §1291 at 177-178 (1962).

There appears to be no factual dispute here as to what happened. Plaintiff contends that at the time it made its initial demand for payment, the provision of the contract which allowed for a twenty-five percent interest rate in the event of default was overlooked. In its original calculations, plaintiff determined the outstanding principal to be $896,705.87 with $189,896.51 owed in interest. Subsequent to the FmHA's payment of the foregoing amounts, plaintiff alleges it discovered that it had inadvertently used the wrong interest rate in its calculations. This discovery resulted in plaintiff's request for additional interest which was rejected by the FmHA. Defendant does not dispute this, though it does not characterize this as a mutual mistake.

In order to prove the affirmative defense of accord and satisfaction, the defendant must show a disputed claim or substituted performance agreed upon and accomplished and valuable consideration. *See Chesapeake & Potomac Telephone Co. v. United States,* 228 Ct. Cl. 101, 108-109, 654 F2d 711, 716 (1981). Mutual mistake obviates the existence of such a dispute.

It is clear from reading plaintiff's and defendant's affidavits that plaintiff had no intention of abandoning its right to demand the rate of interest at twenty-five percent in the event of default. There was no evidence presented by the defendant which would show that, in fact, a dispute existed, or, that plaintiff and defendant agreed to a compromised claim. It is clear from the record that the FmHA

did not offer substantial performance in satisfaction of the debt, which plaintiff accepted, and which bound the parties. There is no evidence of an accompanying expression sufficient to make the plaintiff understand that it had been offered substituted performance in full satisfaction of its debt. A. Corbin *supra*, § 1277.

In the case at bar, defendant made no attempt to compromise the amount owed plaintiff. It is clear from the record that it was plaintiff who made the demand upon defendant; there was never a dispute as to the amount owed until the discovery of the calculation error and the second demand was made. Since a dispute is an essential component of accord and satisfaction; defendant's contention that the debt owed to plaintiff was extinguished does not comport with the facts of this case.

To support its premise that the parties entered into an accord and satisfaction, defendant relies on *Deal v. Federal Housing Administration*, 260 F.2d 793 (8th Cir. 1958). The plaintiffs in *Deal* sued the Federal Housing Authority ("FHA") which had insured a mortgage loan and administered property after a default by the borrower. The FHA sold the property and prepared a detailed accounting which was accepted by plaintiff mortgagee.

In *Deal*, however, the District Court found no mistake of fact or law. And the court raised "serious doubt" as to whether the intervenor appellant, against whom the defense of accord and satisfaction was addressed, and who was seeking an accounting, was in a position to question the accounting. In our case the claim arises under very different circumstances. The accounting was performed by plaintiff albeit erroneously. In light of

contemporary administrative law doctrine, it might also be questioned whether the court in *Deal* would have come to the same conclusion about the intervenor's right to an accounting. *See generally Association of Data Processing Service Org. v. Camp*, 397 U.S. 150 (1970). And, of course, most significantly mutual mistake does exist in this case.

III. Whether the parties intended to incorporate by reference the entire Loan Agreement into the Lender's Agreement?

Plaintiff contends that the parties intended to incorporate by reference the Loan Agreement into the Lender Agreement and the Note. Defendant argues that if the parties wished to incorporate by reference an extraneous writing into the contract for a particular purpose, that purpose must be specified and that there is no such evidence in this case. Defendant also takes the position that the mere reference "see enclosed Loan Agreement" contained in paragraph 11 of the Lender's Agreement, limits the incorporation to that section which deals with the schedule for submission of periodic financial statements by the Borrower (paragraph 9(A)). Thus, defendant argues, the language of the Loan Agreement generally and the default provisions specifically are not incorporated within the Note as part of the loan, but rather, the agreement was incorporated as a collateral agreement for security purposes only. According to this argument, FNB may have rights against the Borrower, but liability does not arise under the guarantee for the added interest in the event of default.

However, no specific language is necessary to incorporate an extraneous document by reference. *See Lowry*

and Co. v. S. S. Le Moyne D'Iberville, 253 F. Supp. 396, 398 (S.D. NY. 1966), *appeal dismissed per curiam on other grounds*, 372, F.2d 123 (1967).

Although plaintiff concedes that paragraph 11 of the Lender's Agreement refers to the Loan Agreement and requires Borrower to make periodic financial statements to the Lender, it also contends that if the parties intended to limit the incorporation solely to the submission by Borrower of monthly financial statements, they would have specified only that section. Here, that is not the case. The language "See enclosed Loan Agreement" does not specify which section of the Loan Agreement was intended to be incorporated. Therefore, the only reasonable inference is that the parties intended to incorporate the entire document by reference. It should also be noted that the entire Loan Agreement was provided to the FmHA for its review. This also lends support for plaintiff's position since presumably the entire document would not have been supplied if only one provision of it was applicable. At the very least, there should have been limiting language in the Lender's Agreement which would reflect which provisions were applicable and incorporated by reference.

IV. Proper calculation of the interest period.

The final issue raised by this litigation is the proper determination of the interest period. Defendant urges the court, to use May 1, 1982, as the proper date of default and arrives at $48,719.37 as the proper amount due if plaintiff prevails. Plaintiff argues that the date of default was October 26, 1981. It is the court's view that the proper default date was October 26, 1981. This

is based upon the fact that when plaintiff received its last payment in February of 1982, that amount only brought the note current through October 26, 1981. Thus, the October date is the appropriate date at which to set the default for purposes of calculating interest.

The court finds two reasons persuasive for this finding. First, when plaintiff agreed to allow Borrower to defer payments, it did so after the loan was in default. Clearly, there was no consideration for plaintiff's agreement for the deferral. Second, due to the fact that there was no consideration for plaintiff to defer payments, it would be unreasonable and inequitable to penalize plaintiff for attempting to assist Borrower. To do so would stand equity on its head and fly in the face of the public policy rationale which encourages lenders to refrain from invoking default procedures, if at all possible, against borrowers. In effect, defendant's position on this issue would punish this plaintiff for acting as a reasonable lender. People should not finish last merely because they are "nice guys."

Conclusion

Based upon the foregoing reasons, the court grants Plaintiff's Motion for Summary Judgment. Defendant's Cross-Motion for Summary Judgment is denied.

The Clerk is directed to enter judgment in favor of plaintiff in the amount of $83,414.53 plus simple interest at the rate of seven percent from March 7, 1985, until the date of payment. Each party will bear its own costs.

/s/ Loren A. Smith
Loren A. Smith
Chief Judge

FARMERS HOME ADMINISTRATION, USDA

7 C.F.R. §1980.22 Charges and fees by lender.

(a) *Routine charges and fees.* The lender may establish the charges and fees for the loan, provided they are the same as those charged other applicants for similar types of transactions.

(b) *Late payment charges.* Late payment charges will not be covered by the Loan Note Guarantee. Such charges may not be added to the principal and interest due under any guaranteed note. Late payment charges may be made only if:

(1) *Routine.* They are routinely made by the lender in all types of loan transactions.

(2) *Payments received.* Payment has not been received within the customary time frame allowed by the lender. The term "payment received" means that the payment in cash or by check, money order, or similar medium has been received by the lender at its main office, branch office, or other designated place of payment.

(3) *Calculating charges.* The lender agrees with the applicant in writing that the rate or method of calculating the late payment charges will not be changed to increase charges while the Loan Note Guarantee is in effect.